

VZCZCXYZ0000
PP RUEHWEB

DE RUEHMO #0101/01 0161417
ZNY CCCCC ZZH
P 161417Z JAN 09
FM AMEMBASSY MOSCOW
TO RUEHC/SECSTATE WASHDC PRIORITY 1524
INFO RUEHDX/MOSCOW POLITICAL COLLECTIVE PRIORITY
RUCPDO/DEPT OF COMMERCE WASHDC PRIORITY
RHEHNSC/NSC WASHDC PRIORITY
RHEHAAA/WHITE HOUSE WASHDC PRIORITY

C O N F I D E N T I A L MOSCOW 000101

SIPDIS

STATE FOR EUR/RUS
COMMERCE FOR MAC (MATT EDWARDS, JAY THOMPSON, JACK BROUGHER)
STATE PLS PASS USTR (HAFNER, KLEIN)
STATE PLS PASS USDA/FAS FOR OCRA (KUYPERS)
STATE PLS PASS EXIM BANK

E.O. 12958: DECL: 01/15/2019
TAGS: [ETRD](#) [EAGR](#) [EINV](#) [ECON](#) [RS](#)
SUBJECT: INCREASED HARVESTERS DUTIES WILL HURT JOHN DEERE
AND OTHER FOREIGN COMPANIES' SALES

REF: A. 08 MOSCOW 3745
[1](#)B. 08 MOSCOW 3678
[1](#)C. 08 MOSCOW 3151
[1](#)D. 08 MOSCOW 2315

Classified By: A/DCM Eric T. Schultz, Reasons 1.4(b,d).

SUMMARY

[1](#)1. (C) Increased duties on imported harvesters and financing problems will cause foreign agricultural equipment sales in Russia to plummet in 2009, affecting major U.S. and EU producers such as John Deere. GOR suggestions that foreign producers could avoid the duty problems by setting up domestic production do not appear realistic, given global credit conditions and the other major capital commitments of leading foreign producers. The duty increase runs afoul of Russian trade commitments with the U.S. and EU, and Russia's G20 and APEC pledges not to raise duties in response to the global financial crisis. However, Russia is making duty decisions based not on international obligations, but rather on a desire to protect domestic industries struggling to cope with the crisis. In senior-level engagements with Russian officials, we should continue to press Russia to adopt an alternative approach to the financial crisis that does not risk provoking a downward spiral of "beggar thy neighbor" protectionist trade measures that would only serve to

lengthen the time needed for Russia and other countries to emerge from the global crisis. END SUMMARY.

Putin Raises the Duties on Imported Harvesters

[1](#)2. (SBU) On January 14, the GOR published an order increasing the duty rate on all classes of harvesters from the current 5% ad valorem rate to 15% but not less than 120 Euros per kilowatt of engine capacity. The new duty increases will become effective as of February 15 and will be valid for an initial temporary period of nine months. (Most duty changes in Russia are first implemented for a nine-month period, after which the GOR determines whether to make the duty changes permanent or to let them expire.)

[1](#)3. (SBU) Sources at the Ministries of Agriculture and Economic Development indicated that there was considerable interagency debate about the duty increase, with both of

those ministries arguing for a more modest increase in the duty rate along the lines proposed in December by the GOR Tariff Policy Commission chaired by First Deputy PM Zubkov. However, the higher duty rate was consistent with protectionist comments from PM Putin on December 11, when he toured the Krasnodar facilities of Rostselmash, the main domestic producer of harvesters (Ref B). In the wake of massive layoffs and productions declines at Rostselmash, Putin pledged to protect it from foreign competitors and endorsed the idea of a 15% duty rate for imported harvesters.

14. (C) Contacts at the Ministry of Industry and Trade (MIT) told us unofficially that the pending safeguards investigation of imported harvesters (Ref D), which is scheduled to conclude on February 15, would determine that no further action against imported harvesters is necessary, in light of the duty increase. However, MIT would revisit the safeguards issue again in nine months when the GOR next reviewed the temporary duty increase.

Financing Problems

15. (C) Deere and Company Russia Country Director Sidney Bardwell told us that both Deere's dealers and Rosselkhozbank (Russia's main agricultural lender) stated that the GOR had issued an order signed by PM Putin that declared a moratorium on the subsidization of foreign agricultural equipment purchases. Bardwell explained that prior to the issuance of the GOR order, the GOR had supported a financing program under which the GOR would cover up to 80% of the financing costs for agricultural equipment purchases, in which Deere and other major foreign producers participated.

16. (C) Bardwell noted that Rosselkhozbank's president had issued instructions to all of its branches prohibiting loans to finance the purchase of foreign agricultural equipment, regardless whether the loans were subsidized by the GOR or were made at commercial rates. Bardwell said he had not yet been able to obtain a copy of either Putin's directive or the Rosselkhozbank instructions, but the existence of both documents had been confirmed by both Deere's dealers and its Russian banking contacts. (As of January 16, no order regarding the subsidization of agricultural equipment purchases has been published in Rossiiskaya Gazeta, the official publication for government orders, but Putin did mention the financing moratorium in his December 11 Krasnodar statement, discussed in Ref B.)

17. (C) In Deere's case, Bardwell noted that there was a \$97 million EximBank credit facility in place with John Deere Credit Company and Rosselkhozbank, but Rosselkhozbank officials had nonetheless told Bardwell that they were under instructions not to finance any foreign agricultural equipment purchases, even with the EximBank facility in place. Bardwell noted that Sberbank might be a potential alternative lender for foreign agricultural equipment purchases, but there was no EximBank credit facility in place with Sberbank, and it also appeared that Sberbank did not have sufficient funds to extend credit to Deere's dealers and farmers in the current financial conditions.

Impact on Sales Will Be Severe

18. (C) Bardwell forecast that the combination of the duty increases and the Russian financing moratorium would lead to a 75% reduction in Deere's harvesters sales in 2009 compared to the sales level achieved in 2008. He added that U.S. firms Case New Holland and Agco, and German producer Claas, would see similar declines in sales. He explained that the big commercial farm operations would still want to purchase larger-capacity harvesters supplied by the foreign producers instead of the smaller-capacity harvesters that Rostselmash

was producing. The duty increase and financing moratorium would have the greatest impact on sales to small and medium-size agricultural producers.

¶9. (C) For other agricultural equipment (tractors, seeders and tillers), Bardwell projected that Deere's sales would fall by 60-65% in light of the Russian financing moratorium on foreign agricultural equipment purchases. If neither the duty increase nor the financing moratorium went into effect, Bardwell believed that 2009 sales would in any event still decline by 30-40%, because of the global financial crisis and weak economic conditions in Russia, particularly in the agricultural sector.

Can Foreign Firms Set up Domestic Production?

¶10. (C) Bardwell said three years ago, GOR officials had rejected proposals from Deere and other foreign agriculture equipment producers that they be permitted to set up domestic production operations under favorable tax and customs terms like those given to foreign car manufacturers. However, he said contacts at the Ministry of Agriculture had recently suggested that Deere "apply again" in the wake of the increased duties on harvesters. (NOTE: GOR officials often suggest that foreign producers' trade problems will go away if they establish domestic production or joint ventures. As discussed in Ref D, industry insiders and observers believed that the original safeguards investigation of harvesters was brought in order to pressure the foreign producers to set up domestic production plants. END NOTE)

¶11. (C) Bardwell noted that while Deere and other companies had the financial means to undertake such projects three years ago, current credit conditions and major existing capital commitments to comply with new North American and EU emissions standards, now made it unlikely that any of the companies could commit to further capital expenditures in Russia.

EU and US Lodge Protests

¶12. (C) On January 14, both EU and U.S. trade negotiators (in Moscow for informal trilateral talks on Russia's WTO accession) lodged objections to the harvester duty increases with Russia's Chief WTO Negotiator, Maksim Medvedkov. In addition to ignoring the pledge not to raise duties contained in the November 2008 G20 Declaration, the EU noted that this was the second time in a row (after the recent increase in the car duties) that Russia had failed to engage in consultations with the EU before raising duties, in violation of Article 16 of the Russia-EU Partnership and Cooperation Agreement. U.S. negotiators suggested the GOR refrain from using duty increases in response to the financial crisis, and told Medvedkov that the duty increase violated the U.S.-Russia side letter on harvester duties (which capped the duty rate at 5% ad valorem) agreed to as part of the Russia-U.S. Bilateral WTO Market Access Agreement in November ¶2006.

¶13. (C) The financing moratorium for the purchase of foreign agricultural equipment, if confirmed, may also raise national treatment and MFN issues for Russia with its trading partners.

Protectionism is a Cheap Response to the Financial Crisis

¶14. (C) Bardwell stated that the recent protectionist increases in duties on both cars (Ref A) and harvesters suggested that the GOR viewed duty increases as a potential source of additional revenue, in the wake of falling oil and gas prices. In Bardwell's view, the GOR likely also believed that duty increases were a cheaper alternative than trying to support struggling domestic industries through direct

financial support programs that would put further pressure on the federal budget.

COMMENT

¶15. (C) Russia has imposed duty increases in quick succession on cars (Ref A), harvesters, and certain steel products (on which there were lengthy consultations between Russia and the EU). We agree with Bardwell's assessment that the GOR will continue to view duty increases as a cheap and quick fix for domestic industries struggling to cope with the financial crisis. As we continue to engage senior Russian interlocutors, we should emphasize the importance of avoiding "beggar thy neighbor" duty increases that will only serve to lengthen the current crisis for both Russia and its trading partners.
RUBIN